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ORIGINAL

September 24, 1998

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By Hand

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: **CC Docket No. 98-141 – Ex Parte**

Dear Ms. Salas:

On Wednesday, September 23, 1998, James S. Kahan, Senior Vice President-Corporate Development; Zeke Robertson, Senior Vice President-FCC; Wayne Watts, General Attorney and Assistant General Counsel; Jonathan P. Klug, Managing Director-Corporate Development and Todd Silbergeld, Director-Federal Regulatory, each of SBC Communications ("SBC"), and Jack Grubman of Salomon Brothers, met with the FCC Staff members shown on Attachment A to discuss the above-referenced Docket.

At this meeting, Mr. Grubman described his views regarding the reasons for and benefits of the proposed merger of SBC and Ameritech and, in particular, the plan to implement the "National-Local Strategy." His presentation was based on the charts accompanying this letter. The principal points which he addressed in his presentation are summarized below:

The New Telecommunications Marketplace

Mr. Grubman opened by stating his widely disseminated view that RBOCs, like SBC, cannot expect to continue to achieve double-digit earnings gains over the near and long term by remaining confined to their regions. Fueled by rapid technological change, including the emergence of large data transmission and other requirements, he said that large and mid-size business customers are increasingly looking to have all (or substantially all) of their telecommunications services provided by a single carrier at all of their locations, both in the U.S. and abroad. He noted that these customers are responsible for a very important and, relative to residential and small business customers, a disproportionate share of revenues. These are customers that a company like SBC cannot afford to lose if it is to maintain its historical growth and earnings, and be able to continue to provide state-of-the-art products and services to all of its customers at affordable and competitive rates. Thus, he stated his belief

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that, in order to retain these customers, SBC would need to be able to "follow" them and provide services to them at all (or substantially all) of their facilities.

Moreover, in order to provide reliable and diverse service offerings to these customers, it is essential that the carrier have facilities which can serve all of the customers' locations. This not only preserves the integrity of the service offerings, but also lowers the cost of providing the services. Mr. Grubman believes that an ILEC that confines itself to its region can certainly remain viable, and at least some of the large ILECs may continue to pursue such a strategy, but Mr. Grubman also believes that such a strategy would not be consistent for a company like SBC that seeks to preserve higher earnings and value for its shareholders.

<u>Competing Out-of-Region</u>

Mr. Grubman noted that he had met with senior officers of SBC earlier this year and expressed his view that SBC needed to undertake significant further out-of-region expansion on a facilities basis in order to address the needs of the new marketplace. He cited the fact that CLECs are now – for the first time – adding more business customers and lines than are the RBOCs. He also pointed to the (now-approved and consummated) WorldCom/MCI merger, which gives that company a nationwide footprint, as evidence of both the viability of competitive local exchange service and the need for major telecommunications carriers to initiate widespread CLEC strategies of their own. He noted that, among all of the RBOCs, SBC has for some time been acutely aware of the need to pursue out-of-region activities, as evidenced by its cellular business, its investments in foreign carriers, and its acquisition of Pacific Telesis. However, these activities alone have not yet placed SBC in the position where it could launch a nationwide and global local exchange competition initiative. To achieve that goal, several non-company-specific alternatives were discussed, such as incremental de novo entry, joint ventures or partnerships, and acquisitions.

<u>The SBC/Ameritech Merger</u>

Mr. Grubman was not aware of SBC's plans to merge with Ameritech until approximately a week before the merger was announced (in early May 1998). However, he stated that the merger is consistent with and a confirmation of the views he had previously expressed to SBC management regarding the steps SBC needed to take in light of the significant changes taking place in the telecommunications market (as explained in each of Mr. Grubman's reports issued immediately after the announcement of the merger, copies of which are included as Attachments B and C).

He believes that the merger will increase the likelihood of success of SBC's out-of-region CLEC initiative, and enable it to undertake that initiative in a manner that protects its shareholders and meets the expectations of the financial community.

He explained that, while SBC could, from a capital expenditures standpoint, afford to enter 30 or more out-of-region markets on its own, such an action would be viewed in a highly negative manner by its shareholders, and the investment community in general, because of the significant dilutive effect which such an action would have on its earnings, as illustrated in the accompanying charts. As a further example, he cited the adverse impact on MCI's stock price when it announced its standalone CLEC project – MCI Metro – in early 1994.

Specifically, Mr. Grubman explained that, unlike CLECs and their investors, who generally are looking for growth, rather than dividends, and who are packaging themselves for eventual sale, the shareholders of RBOCs like SBC are largely individuals and institutions that are income oriented. He noted that SBC has been viewed as highly desirable to this latter group of investors due to its history of double-digit earnings gains each year. However, he does not believe that earnings growth could be sustained if SBC were to undertake a substantial, facilities based out-of-region expansion on its own – an initiative which he believes SBC must undertake in order to compete effectively for large and mid-size business customers. By merging with Ameritech, however, he believes that SBC can substantially increase both the revenue base over which to spread the costs of the out-of-region initiative and the number of in-region customers to "follow" out of region. Thus, he believes that the merger makes the out-of-region expansion possible and that, absent the merger, SBC would be unable to implement the initiative.

Effects of the National-Local Strategy

Mr. Grubman described the National-Local Strategy as a "declaration of war" on the other large ILECs and – far from re-creating the former Bell System – as the "saw that breaks the logjam in opening up local competition." First, he noted that this is the first time an RBOC has announced plans to compete out of region directly and extensively against other large ILECs in the provision of local exchange service. As noted in the accompanying charts, the impact of this strategy will be felt particularly by the other RBOCs. Second, he emphasized that SBC plans to compete out of region not only for large and mid-size business customers, but also for residential and small business customers which, he believes, will be a logical extended use of its new out-of-region facilities. This will have a particular impact on AT&T which has the largest base of residential and small business customers. Third, Mr. Grubman believes that the IXCs and other large ILECs will be forced to respond by entering into local competition within the SBC/Ameritech region, including competition for residential and small business customers, in order to protect their customer base and revenues. Finally, he expressed the view that, since a critical component of the National-Local Strategy is the ability of the combined company to meet the full range of telecommunications needs of its in-region customers, it is essential that the combined company obtain Section 271 relief promptly, which will further accelerate market opening activities within the combined company's region.

Conclusion

At the end of his presentation, Mr. Grubman emphasized his belief that this merger is a logical and necessary step for SBC and Ameritech, that it will clearly foster the type of competition that was envisioned by the Telecommunications Act of 1996, and that it is demonstrably in the best interests of the merging companies' customers and shareholders.

* * *

SBC is filing this ex parte presentation in accordance with Section 1.1206(a)(2) of the Commission's Rules. SBC and Ameritech would be pleased to answer any questions the Staff may have regarding the foregoing matters, or to provide any additional information the Staff may require in connection with its consideration of the pending transfer applications.

Very truly yours,

Wayne Watts

Attachments

cc: FCC staff members listed on Attachment A

ATTACHMENT A

ATTACHMENT

SBC-Ameritech Merger – CC Docket No. 98-141

Ex Parte Presentation – September 23, 1998

FCC Attendance

Lisa Choi, Common Carrier Bureau, Policy and Program Planning Division

Patrick DeGraba, Office of Plans and Policy

Bill Dever, Common Carrier Bureau, Policy and Program Planning Division

Jennifer Fabian, Common Carrier Bureau, Policy and Program Planning Division

Johnson Garrett, Office of Plans and Policy

Jake E. Jennings, Common Carrier Bureau, Policy and Program Planning Division

Radhika Karmarkar, Common Carrier Bureau, Policy and Program Planning Division

Thomas Krattenmaker, Office of Plans and Policy

Pamela Megna, Office of Plans and Policy

Bill Rogerson, Office of Plans and Policy

Marilyn Simon, Office of Plans and Policy

To-Quyen Troung, Common Carrier Bureau, Policy and Program Planning Division

Attachment B

Salomon Smith Barney Research Industry Note

Headline: Ramifications of SBC Announcements: Bell vs. Bell Warfare-Part I/II

Analyst: Jack B. Grubman (212) 816-2877
Analyst: Christine Gochuico (212) 816-2862
Release Date: 05/12/98

SB Industry: Telecommunications Services
Sector: Media/Telecommunications
Industry(s): Telephone Systems: All
Associated Ticker(s):SBC, AIT, BEL, BLS, USW, GTE, T, FON, WCOM, ICIX, ICGX, WCII, NXLK, MCLD, TGNT, RCNC, HYPT

--SUMMARY:---

*SBC announced the acquisition of Ameritech & an aggressive national CLEC strategy targeting 30 cities out of SBC and AIT regions.
*We will not comment on financial ramifications of deal to SBC given our advisory role to SBC.
*SBC's nat'l CLEC strategy is an indication that SBC is very serious about becoming a nat'l & global provider of integrated services by embarking on a strategy that will leave it with a nat'l local footprint of which to leverage itself into being an integrated voice & data provider of services
*Ramifications of SBC actions clear. SBC will aggressively go after BEL, BLS, USW & GTE to provide service to bus. & some res. customers in major mkts of these ILECs. Also, SBC's actions clearly endorse the current valuation of CLECs & obviously make some CLECs clear acquisition targets.

--OPINION:---

SBC announced that it will acquire Ameritech at a stock exchange ratio of 1.316 shares of SBC for every share of Ameritech. The deal is expected to close in the middle of 1999 and SBC announced that the deal will be 7% dilutive in 2000, 3% dilutive in 2001 and accretive thereafter. Salomon Smith Barney is the financial advisor to SBC on this transaction, therefore we will refrain from commenting any further or providing any judgment as to financial ramifications to SBC of this acquisition aside from what was disclosed in the press release.

We still are not going to make precise forecasts at this time other than what the company guidance was. However, we will point out that SBC's experience with PacTel suggests that synergies can come faster and greater and SBC's experience in being the first out of region cellular operator suggests that SBC is not only serious but will have a much bigger business as an out of region CLEC than what is implied in their forecast. Our view of the world has been very clearly stated for some time--you cannot be an in-region defensive operator and expect to grow at a sustainable double digit rate. In addition, we are fundamental believers in having national end-to-end connectivity and therefore, what SBC is doing with Ameritech in conjunction with the CLEC strategy will give SBC a footprint off which to launch national data and voice platforms and with which to become a very appealing strategic global partner. If you think about what is likely to drive the numbers above and beyond company guidance for the next several years, it is the ability of management to realize these synergies--we think Ed Whitacre stands beside Bernie Ebbers as the only two executives in this industry that actually not only do what they say but do more than what they say, and the CLEC strategy which is dependent upon the belief that SBC can compete outside of its home territory--and that has been demonstrated in the cellular business.

However, we will comment on the ramifications of SBC's other announcement today, that being its intent on becoming a national local company by virtue of embarking on a national CLEC strategy. Specifically, SBC has stated that it will enter 30 major markets outside of its and Ameritech's territory for the purposes of being a full blown competitive local exchange carrier. These 30 markets currently have almost 18 million business lines, 69 million total population and we anticipate SBC will target 3,000 fiber route miles or about 100 mile networks per market. SBC will enter these markets through a variety of means ranging from building their own full facilities-based network including fiber and switching to utilizing smart builds where SBC will lease or otherwise obtain transport and put in switching elements, to partnering with existing CLECs or other providers of alternative telecom services and of course, outright acquisition of existing CLECs who happen to already be operating in these markets.

Investors are wondering about the link between the acquisition of Ameritech and the CLEC strategy--the link is more for revenue generation as opposed to the cost of implementing the strategy. Whatever it costs SBC to implement a 30 market CLEC strategy (which will probably run in the $2.5 billion range) or if they have to make some acquistions to accelerate the process, those costs will occur regardless of whether they own Ameritech. However, given that Ameritech adds a lot more business customers to the mix, SBC with Ameritech will generate roughly 27% of the originating long distance minutes versus 16.5% on a SBC standalone basis. Ameritech's business customers added to SBC's business customers could accelerate the revenue generation on the network that SBC builds. For example, SBC is targeting Phoenix as a CLEC territory. United Airlines is a big Ameritech customer in Chicago and has a big facility in Phoenix. Therefore, they would be a natural customer to utilize a new SBC service offering that connected its Chicago offices with the Phoenix facility. SBC will forge ahead with its plans and the cost of implementation is invariant to the Ameritech acquisition, but clearly Ameritech's base of customers added to SBC's should accelerate the positive contribution the out-of-region CLEC efforts make to SBC relative to what they would have been on a SBC standalone basis.

SBC's action is a clear endorsement of our thesis for how this industry will evolve. SBC is simultaneously saying that even it, the best managed RBOC cannot sustain the type of earnings growth it would like to over a long period of time by simply being a regional carrier defending its base. Secondly, SBC is also saying that one must have national presence in order to truly be a national and ultimately global carrier of integrated voice, data and IP services. These are themes we have been stressing for some time. This is particularly important while serving business customers whose needs tend to transcend RBOC regional barriers. For example, Anheuser Busch on whose Board Ed Whitacre, the Chairman of SBC, serves was slowly but surely taking business away from SBC in St. Louis simply because SBC could not serve Anheuser Busch locations in places such as Tampa and elsewhere. By having the facilities to follow large customers around, SBC will enhance its ability to capture long distance traffic within its region and will also enhance its ability to keep local service from these business customers.

The Ameritech acquisition stands on its own merits from a synergy perspective and clearly does not impact the cost of entering these CLECs markets. However, we would argue having Ameritech's base of customers along with SBC's base of customers enhances the economics of these out-of-region CLEC markets since they will be many more "in-region" customers to follow around the country thus enhancing the revenue potential for SBC's out-of-region strategy. Thus, while we will not comment on the financial aspects of the SBC/Ameritech deal or the specific financial impacts of the national CLEC strategy (although anyone following CLECs realize during the build-out phase there will be some modest dilution above and beyond the stated dilution from Ameritech but one would expect a very positive net present value from the CLEC operation which should enhance the longer term growth rate of the combined entity). We will now comment on the ramifications for the rest of the industry of SBC's national CLEC announcement.

OBVIOUSLY POSITIVE FOR THE CLECs

The SBC national CLEC strategy is obviously positive for the CLECs for several reasons. First, SBC which is considered by most of the investment community as being the smartest and best run RBOC has now validated the CLEC strategy in a big way. Secondly, SBC clearly will enter some subset of its new markets via acquisition of existing CLECs (in fact the faster SBC acquires a CLEC the better its position vis-a-vis the DOJ). In addition as SBC enters other RBOC markets, we will no doubt see retaliatory strikes. This move by SBC clearly instigates Bell vs. Bell warfare and as a corollary to that instigates Bell acquisitions of CLECs. The combination of validation of CLEC strategy by smart management and clear acceleration of acquisition activity of CLECs without question lowers the risk premium and thus the discount rate one would apply to a CLEC. This is particularly positive for stocks who are DCF stories. Thus, all things being equal CLEC stocks ought to trade significantly higher.

Salomon Smith Barney Research Industry Note

For those worried that SBC entering these markets somehow hampers CLEC market share assumptions, we remind investors that in every CLEC model we do, we assume anywhere from 5-15 competitors per market depending on the size of the market. Currently, there is no more than 3 or 4 competitors in any market including the biggest ones. Thus, SBC entering a market does not alter our standalone market share assumptions for CLECs one iota but clearly increases the probability of acquisition of many of the CLECs we follow, and of course accelerates share loss by these Bells in whose markets SBC is entering.

RAMIFICATIONS CONTINUED ON PART II/II

Attachment C

Salomon Smith Barney Research Industry Note

Headline: Ramifications of SBC Announcements: Bell vs. Bell Warfare-Part II/II

Analyst: Jack B. Grubman (212) 816-2877
Analyst: Christine Gochuico (212) 816-2862

Release Date: 05/12/98

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--OPINION:---

(Continued From Part I/II)

THIS IS CLEARLY NEGATIVE FOR THE OTHER BELLS

SBC, which is a well run and very aggressive RBOC, has basically announced a declaration of war on its fellow Bells. In addition, SBC wll surely open its markets much quicker in order to appease the DOJ (this coming on top of Bell Atlantic's concessions in NY). Thus SBC, in one fell swoop is truly being a lightening rod to break open local competition nationwide with clearly negative impacts to those Bells with a solely in-region strategy. The reason we have always liked Ed Whitacre is in a sense he reminds us of Bernie Ebbers. That is he cares about his shareholders and other constituents such as employees and customers with little regard to being a good member of the telecom management club. We will remind people that SBC has always been the first Bell to break the mold and do transforming strategies. In 1987, SBC was the first to go out of region in buying cellular, in 1990 SBC was the first to go outside of the US with a privatization investment in TelMex, in 1996 SBC-PacTel was the first RBOC merger and now today SBC is the first Bell to declare unilaterally an aggressive competitive strike at other Bells.

To be specific, no Bell is left unscathed by SBC's national CLEC strategy. Of the 18 million business lines in 30 markets SBC is targeting, 9 million of those business lines are in Bell Atlantic territory, representing 70% of Bell Atlantic's business lines, 3.5-4.0 million of the business lines are in BellSouth's territory, representing roughly half of BellSouth business lines, and over 3 million of the business lines are in US WEST's territory representing over 60% of US WEST business lines. Less than 1 million of these business lines are targeted to GTE so on the surface it looks like GTE got off easy since this represents less than 10% of GTE's business lines. However, one has to keep in mind that since SBC sits next to GTE in California and Texas, SBC already has designs on 40% of GTE's business lines if not closer to 50%.

There are no ifs, ands or buts about this. No Bell bull could get around the ramifications of what SBC is doing. SBC basically is willing to open up its in-region territory to competition in order to aggressively strike out of region. The math clearly works for SBC since these 18 million business lines represent more than the combined business lines of SBC and Ameritech and when one peels the onion back further, the 18 million business lines in the 30 target markets are all truly addressable whereas a fairly large subset of SBC's 12 million business lines in particular are in areas that there will be little or no CLEC activity.

We know that there is going to be a lot of speculation about what will be the next Bell merger. Frankly, we think there is a very low probability, if none at all, that anybody will merge with US WEST. SBC and Ameritech were obvious candidates given their contiguous nature relative to USW's region and we think that SBC is unlikely to be able to pull off another Bell merger after it completes the Ameritech deal. Furthermore, USW by virtue of the way the Media Group spin-off was structured, could not do a pooling-of-interests transaction with any other company for two years. In addition, USW's poor service quality is likely to be a burden on a potential acquirer who would have to fork over billions of dollars of non-synergistic expenditures to satisfy any regulators. Frankly speaking, there are only five cities in USW's territory that really matter in terms of traffic, all of which SBC is targeting as a CLEC. As for BellSouth, we have always admired BellSouth's management, organic growth and geographic and economic diversity of its region along with its array of international assets. Certainly, we think BellSouth will make a very good partner for someone down the road but we believe BellSouth's management rightfully views themselves as being the one to control any merged company which of course could raise issues with any potential suitor. As for Bell Atlantic, the market was very efficient yesterday--Bell Atlantic is clearly most hurt by the SBC out of region initiatives given that half of the 18 million lines SBC is targeting are in Bell Atlantic territory which as we said, accounts for roughly 70% of Bell Atlantic's business lines. Thus, if one takes all this into consideration, BellSouth is probably the only RBOC that deserved to trade up yesterday, Bell Atlantic clearly deserved to get hit, and US WEST which was essentially unchanged was probably the proper market reaction.

RAMIFICATIONS FOR OTHERS UNCLEAR

As far as SBC's actions impacting other entities within telecom besides CLECs and Bells, this is not nearly as black and white as it is for the positive ramifications to the CLECs and negative ramifications for the RBOCs. We would say at the margin, an SBC becoming a national entity and with that perhaps accelerating its entrance into long distance can't be good news to AT&T who we would argue is still grappling with its own national local strategy and of course, have a very large and vulnerable residential long distance revenue base.

For WorldCom, this if nothing else is a confirmation that WorldCom's strategy to build facilities both in the US and globally is in fact the industry model others are aspiring to. As we indicated in our WorldCom report of April 9, even with WorldCom's clear headstart as a facilities-based operator in 100 local markets in the US and 35 local markets outside the US, we never have WorldCom attaining much more than a high single digit market share of their truly addressable market. Consequently, we've been anticipating several other fully integrated players and if SBC executes on its strategy then perhaps they are ready to become the second of what would be a list of 5 or 6.

From a Sprint perspective, one could argue either way--on one hand Sprint could be a likely acquisition candidate for either an SBC or others who want to replicate what SBC is doing or one could be left with the impression that companies such as SBC which are stitching together a national strategy may continue to connect the dots that they are building via partnerships with long haul network providers as opposed to outright acquisitions. Frankly on this one it is not obvious what the outcome will be.

Bottom line here is that SBC and Ed Whitacre in particular have made a very bold and gutsy move. The acquisition of Ameritech, which we again will refrain from speaking about, but in regards to the national CLEC strategy this clearly positions SBC to be a player in the national and global game of providing integrated services. More importantly, this truly is the step that we think breaks the law-jam in opening up local competition since we believe SBC will be very much at the forefront of cooperating with regulators in its own region in order to aggressively execute its strategy out of region--something that does not bode well for other Bells who are not nearly as prepared to take this kind of dramatic action.

NET/NET: We must admit that we feel good when a smart forward-thinking executive such as Ed Whitacre essentially endorses what we have been saying for some time. Namely that the world will evolve into 4-6 fully integrated providers of service and that any Bell that stays simply a regional company defending its turf has a business plan that is doomed to see deceleration of growth. From an SBC perspective, we think the strategic move they are making will clearly be additive to long-term shareholder value.

SBC/Ameritech Merger

Ex Parte Presentation

September 23, 1998

SBC / AMERITECH OVERVIEW

- SBC has declared war on the other Bells.
- SBC's National / Local strategy – made possible by the SBC / Ameritech merger – will break open local competition.
- This is NOT a bigger Bell (or "AT&T West") – it is an aggressive competitive strike.

RBOC REALITY

- Business customers represent high volume needed to cover fixed costs.
- Data services are increasingly important.
- Large business customers are seeking to consolidate telecom purchases on a national / international scale.
- <u>RBOC Result</u>: Defense strategy = decelerating growth.

CLEC ADVANTAGES (1)

- **Access to cheap capital**
- **Shareholders focus on growth, not earnings.**
- **<u>Result</u>: CLECs already have surpassed Bells in net new business lines added.**

CLEC ADVANTAGES (2)
Targets Capital Efficiency

- Limited RBOC assets cover majority of business lines

  - ♦ Approximately 10% of the sq. miles in US encompass 60% of access lines

  - ♦ 10-15% of end offices encompass 70% of business lines.

  - ♦ 5% of office buildings encompass 35% of business lines.

  - ♦ Top 30 MSAs in US encompass 50% of business lines.

CLEC ADVANTAGES (3)

- CLECs have a good economic model

  - If a CLEC spends $100m in a market over 10 years:

    - 30 - 40% Upfront

    - 60 - 70% Demand driven

  - And, gets 6-8% market share, with 30% annual churn; 35% year 10 EBITDA margin

  - Then IRR or ROI is 28 - 34% vs. average CLEC cost of capital of approximately 15-17%

SBC NATIONAL / LOCAL STRATEGY (1)

- SBC's strategy was rapidly accelerated in order to respond to MCI / Worldcom.
- Ebbers surprised the industry by building the first real end-to-end network.
- Recent MCI / Worldcom ads tout integration, network ownership, reliability, low cost (*see* attached).

SBC NATIONAL / LOCAL STRATEGY (3)

- **No Bell is left unscathed.**

- **SBC will enter markets representing**

  - **70% of Bell Atlantic's business lines**

  - **60% of U S West's business lines**

  - **50% of BellSouth's business lines**

- **SBC already is positioned to challenge 40-50% of GTE's business lines (in CA and TX).**

RESPONSE TO SBC NATIONAL / LOCAL STRATEGY

- **SBC's entry will force other Bells to expand into SBC's territory.**

- **SBC's competition for residential / small business customers will force IXCs to compete for those customers.**

- **Risk to revenue base is very high.**

- **Customer reality is the same.**

RISKS OF SBC NATIONAL / LOCAL STRATEGY

- Significant capital investment ($2.5-3 billion)
- Growth rate uncertainty
- Earnings-per-share reductions
- Result: Shareholders would NOT support SBC entry alone.

SBC / AMERITECH MERGER

- Key to implementing National / Local strategy
- Larger revenue base reduces risk to shareholders.
- Large customers transcend artificial RBOC boundaries.